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No. 983

In the Supreme Court of the United States

October Term, 1957

TELESERVICE COMPANY OF WYOMING VALLEY,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

---

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court are reported at 27 T.C. 722. The opinion of the Court of Appeals for the Third Circuit (Pet. 1a-16a) is not yet officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered March 24, 1958 (Pet. 17a). The petition for a writ of certiorari was filed May 6, 1958. The jur-

isdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

The taxpayer, a corporation, entered into contracts under which it obligated itself to furnish services to customers in consideration of a price payable in advance and consisting of an initial payment (called a "contribution" toward the cost of the facilities necessary to furnish the services) and subsequent monthly payments (called "maintenance" charges).

The question is whether the initial payments received by the taxpayer under the contracts were part of the price of the services, and consequently includable in taxpayer's gross income under Section 22(a) of the Internal Revenue Code of 1939.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * *

(3) [as amended by Sec. 111(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Gifts, bequests, devises, and inheritances.*—The value of property acquired by gift, bequest, devise, or inheritance. * * *

* * * *

(26 U.S.C. 22.)

STATEMENT

The taxpayer, a corporation, constructed and operates for profit a community antenna television system at Wilkes-Barre and Kingston, Pennsylvania. It was organized to provide television signals to residents of the area through a community antenna system because television reception from stations in other cities was inadequate due to the mountainous terrain of the locality. (Pet. 2a-3a.) The cost of construction of a complete system was calculated to be as much as $250,000, and it was decided that construction would have to be financed principally through contributions from prospective customers or subscribers (Pet. 3a-4a). Contributors were divided into two classes—residential and commercial. The residential customers were to be required to make contributions of $145; the commercial customers $200. These varying scales were fixed by the taxpayer because, although service installation costs were the same with respect to both classes of customers, it believed that the com-

mercial establishments could afford to contribute a greater amount than could a private individual. Taxpayer estimated that the contributions, if it obtained the number of customers anticipated, would just about balance the costs of construction of its entire system. (Pet. 4a-5a.)

The taxpayer's program also provided that residential customers were to pay $4 monthly and commercial customers $6 monthly as a service or maintenance charge in addition to their initial contributions. The monthly charges were designed to cover the maintenance of the community system and included an element of profit to the taxpayer. The rates were not set by any regulatory commission. (Pet. 5a.)

The taxpayer's system was constructed in several distinct stages. The cost of the first stage, $24,138.49, was advanced by the taxpayer's incorporators. On completion of this first step potential subscribers were solicited. (Pet. 5a.)

Taxpayer entered into contracts with the subscribers whereby it agreed "to furnish [each] subscriber at the place of installation * * * a television signal transmission service." The subscribers, in turn, agreed (1) to contribute the sum specified "toward the total cost of constructing a system for the transmission of a television signal" and (2) to pay "a monthly maintenance" charge which would entitle them to receive service. While a contribution was a prerequisite to eligibility to use of the system, it did not entitle the contributor to receive television signals. The contributor was required to make monthly payments, in advance, in order to receive the signals. (Pet. 5a-6a.)

A contributor could not sell, assign, or transfer his eligibility to receive television signals, but he remained eligible to receive the signals without additional cost if he moved to another part of Wilkes-Barre or Kingston. However, the person who moved into the contributor's old home was required to make a contribution in order to become eligible to use the system. (Pet. 6a.)

The contract between taxpayer and its customers was subject to certain "General Provisions" which provided, *inter alia:* (1) if taxpayer from certain causes found it either impossible or impractical to furnish television transmission service it could terminate the contract, in which event all contributions, maintenance rates, and other monies paid by the subscriber were to be forfeited; (2) taxpayer could terminate the contract upon subscriber's default without any obligation to make a refund; and (3) if taxpayer terminated the contract for its convenience the subscriber was to be refunded a part of his contribution, based upon the number of months the contract had been in effect. (Pet. 6a.)

The contribution required of a commercial establishment has never changed. The amount required of residential subscribers was reduced in 1953, 1954 and 1955, and no contributions have been required of them since 1956. Monthly services charges of $4 for a residence and $6 for each commercial establishment have remained unchanged. Antenna connections fluctuated between a high of 900 and a low of 200 or 300. (Pet. 7a.)

During the two tax years (fiscal years 1952 and

1953) taxpayer received total "contributions" of $116,146.77 and expended a total of $133,501.42 towards construction, the balance being financed with borrowed money (Pet. 7a). All funds were deposited in the taxpayer's general bank account, from which were paid general operating expenses and the cost of all assets acquired. However, the taxpayer's accounting system segregated the initial payments, which were credited to an account called "Customer Contributions," from the monthly maintenance charges. The so-called contributions were not applied to any of the expenses normally chargeable to operation, only the monthly service charges being utilized for such expenses. (Pet. 8a.)

The taxpayer in its returns did not include the initial payments (contributions) received from its customers in its gross income. The Commissioner treated the initial as well as the subsequent payments as gross income, and determined deficiencies accordingly. In this determination he allowed the taxpayer a deduction for depreciation of the physical assets of its system purchased with the contributions. The Commissioner's determination was sustained by the Tax Court in a reviewed opinion, one judge dissenting. (Pet. 8a.) The Court of Appeals unanimously affirmed (Pet. 1a-16a).

ARGUMENT

1. The decision below, affirming that of the Tax Court, is correct. This Court has repeatedly held that in adopting the broad definition of gross income contained in Section 22(a) of the Internal Revenue Code

of 1939, *supra*, p. 2, Congress intended to tax all gains except those specifically exempted; and that amounts received in return for services, however labeled, are includable in taxable income. *Commissioner* v. *LoBue*, 351 U.S. 243; *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426; *Robertson* v. *United States*, 343 U.S. 711. In harmony with these basic principles the courts in a variety of settings have held that payments for services constitute taxable income notwithstanding that the recipient allocates the payments to capital expenditures. *Lykes Bros. S. S. Co.* v. *Commissioner*, 126 F. 2d 725 (C.A. 5); *Baboquivari Cattle Co.*, v. *Commissioner*, 135 F. 2d 114 (C.A. 9); *United States* v. *Maryland Jockey Club*, 210 F. 2d 367 (C.A. 4), certiorari denied, 347 U.S. 1014.

Both courts below found that the initial payments which taxpayer received from applicants for its television antenna service—and which it characterizes as "contributions" to its capital [1]—represented advance payment of part of the price of services to be rendered, not tax-exempt gifts or contributions to taxpayer corporation or to its stockholders. Their concurrent finding is unquestionably supported by the record.

It is undisputed that the payments were made pursuant to a contract under which taxpayer legally

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[1] The initial payments were recorded on taxpayer's books as "Customer Contributions" (Pet. 8a). Subsequent monthly payments received by taxpayer from the applicants, called "maintenance" charges (Pet. 6a), concededly represent taxable income.

obligated itself to perform services in exchange; and that only those persons who made the initial payments were eligible to receive the service upon further payment of monthly charges. Those who did not make these payments could not receive the service. In reality, therefore, the initial payments were as much a part of the customers' payments for service as were the subsequent monthly charges. Like any other compensation received, the funds were deposited in taxpayer's general bank account, without restriction as to use. That the amount initially received by taxpayer from its customers was used to defray the cost of materials needed to furnish the agreed services manifestly does not render that portion of the price paid for the services any different for tax purposes than the subsequent portions of the price used to defray the cost of necessary labor; each portion represented a component part of the total contract price for the agreed services paid to taxpayer in advance by the customers, and the first instalment no less than the others was income to taxpayer within the meaning of Section 22(a).

2. The decision below is not in conflict with any decision of this Court or of any court of appeals. The instant case differs materially from *Edwards* v. *Cuba Railroad*, 268 U.S. 628, upon which taxpayer chiefly relies for conflict (Pet. 7); as both courts below pointed out, it is like those cases which have distinguished that case. In the *Cuba Railroad*, this Court was careful to note that (p. 633) "The subsidy payments taxed were not made for services rendered or to be rendered." And this Court subsequently distinguished that case from others where,

as here, so-called capital contributions were in substance advance payments for goods or services. See *Texas & Pacific Ry. Co.* v. *United States*, 286 U.S. 285, 289-290; *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98, 102-103; *Brown Shoe Co.* v. *Commissioner*, 339 U.S. 583, 591. Thus in *Detroit Edison*, in distinguishing *Cuba Railroad* and holding that a utiiity did not acquire a substituted basis for depreciation by virtue of receipt of estimated construction costs from applicants for its services, this Court stated that (pp. 102-103) "it overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company", and that "The payments were to the customer the price of the service." Here, as in *Detroit Edison* and unlike *Cuba Railroad*, the amounts received represented advance payments for future services. In the words of the court below (Pet. 15a), "taxpayer's reliance upon *Edwards* v. *Cuba Railroad Co.*, *supra*, is to state it bluntly, misplaced. The facts in that case are clearly distinguishable."

Nor is the decision below in discord with *Bennet* v. *Helvering*, 137 F. 2d 537 (C.A. 2), the only court of appeals decision with which taxpayer asserts conflict. (Pet. 11.) Indeed, the issue there—whether a taxpayer who failed to report income received in the form of property was estopped to deduct its loss in a later year—was far removed from the one here presented.

To be sure, the Tax Court decisions upon which taxpayer relies (Pet. 11) appear inconsistent with that court's later decision in this case, as both the

Tax Court itself and the court below acknowledged (Pet. 15a). But the Tax Court was of course at liberty to reconsider its previous position (*Louisville Property Co.* v. *Commissioner*, 140 F. 2d 547, 549-550 (C.A. 6th), certiorari denied, 322 U.S. 755). The decision of the Court of Claims (*Texas & P. Ry. Co.* v. *United States*, 52 F. 2d 1040), upon which taxpayer also relies, follows the early Tax Court decisions which have since been rejected. As for the long "administrative application" to which taxpayer points (Pet. 12-13), it consists of the Commissioner's acquiescence in these early Tax Court decisions which both the Tax Court and the court below have now repudiated as unsound in the light of intervening decisions of this Court.

3. The taxpayer's reliance (Pet. 13) upon Section 118(a) of the Internal Revenue Code of 1954, which excludes from the gross income of a corporation contributions to its capital, begs the very point at issue by assuming—contrary to the concurrent finding of both courts below—that the amounts here in question represented contributions to capital rather than advance payments for services. Moreover, as the court below pointed out (Pet. 16a), the pertinent committee reports make it clear that this provision of the 1954 Code merely restated the existing law and does not apply to so-called contributions received in consideration for services. See H. Rep. No. 1337, 83d Cong., 2d Sess., p. 17; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 271-272 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4042, 4621, 4909-4910).

4. The taxpayer asserts (Pet. 13-16) that this case presents an important issue because regulated util-

ities are required to account for receipts such as those in question as contributions to capital rather than as income. There is nothing in the record to indicate (nor is it claimed) that taxpayer is required by any act or regulatory commission to account for payments received from its customers as contributions to capital. Even assuming some utilities are required to do so, it is fundamental that the requirements of an act, such as the Interstate Commerce Act, the purpose of which is to regulate commerce or like activities, and the methods of accounting prescribed or permitted by the regulatory body charged with the duty of administering that act, are not determinative of tax liability under the Revenue Act. *Old Colony R. Co.* v. *Commissioner*, 284 U.S. 552, 562; *Kansas City Southern Ry. Co.* v. *Commissioner*, 52 F. 2d 372, 378 (C.A. 8th), certiorari denied, 284 U.S. 676.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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